4/17/88 BS 350-2

MANUFACTURERS HANOVER

Financial Digest

Volume XXV, Number 4 Friday, February 12, 1988

Analysis of Business Trends Plus Selected Financial Indicators

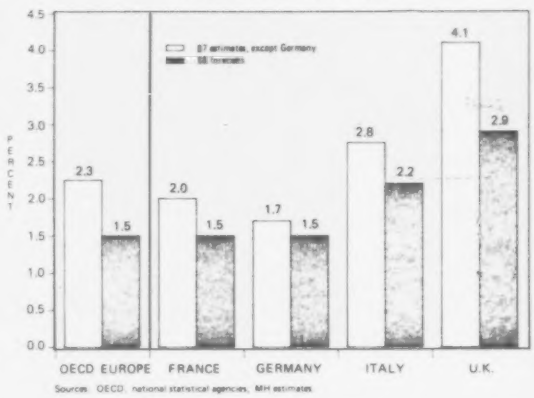
A Mixed Economic Picture In Europe

Although the Federal Reserve's policy-setting Federal Open Market Committee probably spent much of its time at this week's meeting debating just how strong or weak the U.S. economy is, the business outlook in Europe seems somewhat more discernable. With the region's growth prospects clouded both by the persistent sluggishness of the German economy and a fading of global export price competitiveness due to the sharp appreciation of the European currencies relative to the U.S. dollar, another year of subdued economic growth seems likely. To be sure, while such bright spots as the United Kingdom and Spain do exist in this mixed regional picture, they are too few and far between to offer much hope to either the 16¼ million people now unemployed in the European Community, or to those who look for faster European growth to help put a big dent in the wide U.S. trade deficit.

Since Germany alone accounts for one quarter of Europe's gross national product, and is the largest trading partner of several other European countries, subdued German economic growth has a significant impact on the rest of the region. Last year, Germany's "real" economy expanded by an anemic 1.7 percent, prompting an international chorus of calls for the German government to adopt more stimulative economic policies. But despite this, and an unemployment rate that remains stubbornly high, the authorities have been extremely reluctant to prime the economic pump, citing the inflationary dangers of an already brisk pace of money supply growth, which has been above target for two years in a row, and the fact that their Federal budget deficit may surpass the equivalent of two percent of GNP this year, up from a low point of about one percent in 1985. For these reasons, German policymakers believe that their ability to stimulate the economy without reawakening inflation expectations is limited.

Above-target money growth in Germany stems partially from repeated foreign exchange market interventions by the central bank, which is often buying dollars with newly-created Deutschemarks in order to stem the fall of the U.S. currency. And while its threat may have been exaggerated, given the decline in German money velocity, the fact remains that policy is only being altered at a snail's pace and the overall German economy has little forward momentum. Not only was real GNP growth last year actually

REAL GNP/GDP IN SELECTED EUROPEAN COUNTRIES
(ANNUAL GROWTH RATES)



Sources: OECD, national statistical agencies, MH estimates

slower than in the year before, but domestic factory orders are soft, the unemployment rate is rising and the trade surplus remains at record levels. What is more, with consumer prices barely inching higher, wholesale prices stable and Deutschemark-denominated commodity prices plunging, any threat of renewed inflation seems remote.

Sluggish Growth Is Contagious

If the effects of slow German growth and cautious public policies could be confined to Germany, Europe's outlook might be somewhat brighter. However, they can't, and the impact on France, Western Europe's second largest economy, is a good example of why not. With the Deutschemark's external value benefiting from Germany's record trade and current account surpluses, not to mention attractive inflation-adjusted bond yields, the Bank of France confronts a policy dilemma. It is that, despite slow French growth, the central bank is reluctant to ease monetary policy and drive interest rates decidedly lower, since it fears that such a move would place significant downward pressures on the French currency's value versus the mark.

Manufacturers Hanover Economics Department 17/270

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For this same reason, the French central bank found itself forced to hike short-term domestic interest rates in the wake of the October stock price collapse, while its central bank counterparts almost everywhere else were doing the opposite. Although these increases have recently been reversed, this move comes none too soon, since industrial production was flat in November, and the French economy is unlikely to grow by more than 1½ percent this year, even slower than the two percent growth rate expected for all of 1987.

Nor does this bode well for other countries. With the bulk of Western Europe's trade transacted with one another, subdued growth in Germany and France becomes not only self-reinforcing, but contagious. Since Italy's principal export markets are in these two countries, it is hardly surprising that Italian export growth is floundering, a worsening foreign trade balance is acting as a substantial drag on overall growth and the lira is heading lower in the foreign exchange markets (see chart on page 1).

The United Kingdom Bucks The Trend

While the Continental countries continue to

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/27/88)	181,456	+ 802	+ 14,746
New York City (1/27/88)	38,440	+ 891	+ 2,555
Commercial Paper (1/27/88)	377,541	+ 647	+ 43,018

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/27/88)	288,396	– 428	– 6,074
New York City (1/27/88)	56,087	– 603	– 9,822

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/27/88)	864,814	+ 1,321	+18,225
New York City (1/27/88)	174,168	+ 925	–34,124

Financial Markets

	Thursday 2/11/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.79%	– .01	– .01
180-Day Bills†	6.15	– .03	+ .30
Longest Bills†	6.55	+ .04	+ .53
Recent Issues:			
7⅜s 1/31/90	7.08	–0–	
81/4s 12/31/91	7.46	– .03	
81/8s 2/15/98 (When Issued)	8.15	– .04	
87/8s 8/15/17	8.35	+ .05	
Municipals:			
Bond Buyer–20 Bond Index* (2/11/88)	7.40%	– .09	+ .73
Blue List Total ($ Million)	$1,206	+ $ 4	– $683
30-Day Visible Supply ($ Million)	$2,021	– $ 78	– $ 72
Total	$3,227	– $ 74	– $755
Corporates:			
Moody's Aa Composite (2/10/88)	9.53%	– .14	+ .62
30-Day Visible Supply ($ Million)	$1,351	– $565	– $956
Stocks:			
Dow-Jones Averages:			
Industrials	1,961.54	+ 51.06	– 221.81
Transportation	774.14	+ 15.57	– 148.22
Utilities	184.33	– 1.95	– 36.59
65 Stocks	731.15	+ 13.79	– 106.74
N.Y.S.E. Composite Index	143.99	+ 2.64	– 15.57
N.Y.S.E. Avg. Daily Vol. for Week (000's)	180,202	– 11,928	+ 6,098

*34% Taxable equivalent 11.21%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Thursday 2/11/88	Week Ago
Overnight	6.31%	6.44%
1 month	6.50	6.63
3 month	6.63	6.75
6 month	6.69	6.82
1 year	7.00	6.13
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 yrs.)	9.18%	9.18%
Long Term (10 yrs.)	10.22	10.22

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/11/88)	Currency Per U.S. $	Week Ago
Canada	1.2705	1.2710
France	5.7240	5.7080
Germany	1.6904	1.6910
Italy	1247.45	1245.30
Japan	128.98	128.65
Mexico	2239.00	2228.00
Switzerland	1.3871	1.3847
U.K.*	1.7600	1.7620

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (2/11/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.3%	–4.8%

search for a growth spark, the economy of the United Kingdom has been expanding rapidly. Fueled by robust employment and income gains, retail sales are booming and manufacturing output is rising. The subdued inflation rate is running at levels not seen since the early 1960s, while the government's budget should be in the black this year for the first time in nearly two decades. In fact, the principal task of policymakers in the United Kingdom is to ensure that the economy does not overheat, rather than stall—fanning inflation expectations and leading to an unsustainable widening of the trade deficit.

On balance, Europe's mixed economic picture contains both pluses and minuses for the global economy. On the plus side, modest growth in many of the largest industrial countries helps to keep a lid on commodity prices and inflation rates. However, there seem to be more minuses: A slowly expanding European economy dims the job prospects of the area's unemployed, compounds the financial difficulties of the developing countries and, of special importance to the United States, impedes the correction of the large trade and current account imbalances which currently plague the U.S. economy and the financial markets. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/3/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	225.543	– 1.573	+16.501
Loans to Depository Inst.	.293	– .129	– .155
Float	1.052	– .412	+ .121
Total Reserve Bank Credit	242.458	– 2.311	+14.167
Treasury Deposits with Federal Reserve Banks	8.125	– .816	– 4.770
Currency in Circulation	223.413	– .831	+17.781
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	212.987	+ 2.756	+46.312
	1/27/88		
Member Bank Reserves:			
Total Reserves Held	59.375	– 2.302	+ 2.148
Excess (Deficiency)	1.308	+ .004	+ .102
Net Free Reserves	1.132	+ 1.464	+ .388
		% Change Since	
Monetary Aggregates †		**3 Months Ago***	**Year Ago**
M1 (1/25/88)	766.3	+ 0.4‡	+ 3.3‡
M2 (December '87)	2,895.4	+ 2.7	+ 3.4
M3 (December '87)	3,662.6	+ 4.6	+ 4.9
Domestic Nonfinancial Debt (3rd Q'87)	8,139.1	+ 7.6	+ 10.0

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 2/11/88	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.66%	5.90%	6.17%
* Federal Agencies	6.30	6.30	6.35
* Municipal Notes—High Grade (34% Taxable Equivalent)	6.44	6.67	7.12
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	6.55	6.60	6.90

‡Finance Company Paper—Prime

5- 14 days	6.35%
15- 29 days	6.40
30- 59 days	6.40
60- 89 days	6.40
90-179 days	6.40
180-239 days	6.30
240-270 days	6.30

‡* Bankers' Acceptances

Mar.	6.38%
Apr.	6.38
May	6.38
Jun.	6.38
Jul.	6.38
Aug.	6.38

‡Industrial Paper—Prime

30- 89 days	6.45%
90-120 days	6.45

†Federal Funds Effective Rate 6.47%

‡Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'87	$ 4,598	$ 4,524	$ 4,288
Gross National Product (1982 Dollars)*	4th Q'87	$ 3,875	$ 3,836	$ 3,732
Percent Change, Annual Rate	4th Q'87	4.2	4.3	1.5
Change in Consumer Prices*	Dec '87	1.2%	3.6%	2.4%
Change in Producer Prices*	Dec '87	– 3.6%	0.0%	1.2%
Civilian Employment (Thousands of Persons)†	Jan '88n	114,129	113,744	111,014
Unemployment as % of Civilian Labor Force†	Jan '88n	5.8%	5.8%	6.7%
Personal Income*	Dec '87	$ 3,865	$ 3,836	$ 3,613
Leading Indicators Composite Index (1967=100)†	Dec '87n	190.7	191.0r	186.7
Industrial Production Index (1977=100) †	Dec '87	133.2	133.1	126.9
Net Change in Consumer Installment Credit †	Dec '87n	$ 4.45	$ 2.63r	$ 0.14
U.S. Merchandise Trade Balance	Nov '87	–$ 13.22	–$ 17.63	–$ 19.22
Plant and Equipment Expenditures*	1st Q'88	$427.97(a)	$417.25(a)	$372.24
Private Housing Starts (Thousands of Units)*	Dec '87	1,374	1,639	1,813
New Construction Expenditures*	Dec '87n	$ 409.7	$ 411.3r	$ 380.9
Total Business Inventories †	Nov '87	$ 695.5	$ 689.9	$ 655.3
Total Business Sales †	Nov '87	$ 461.4	$ 462.4	$ 429.8

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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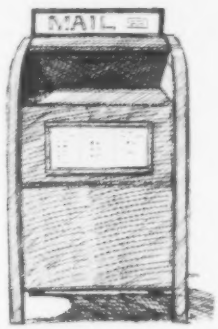

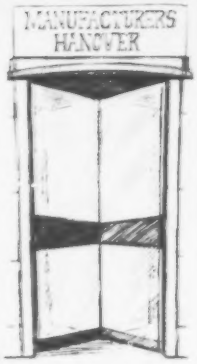

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